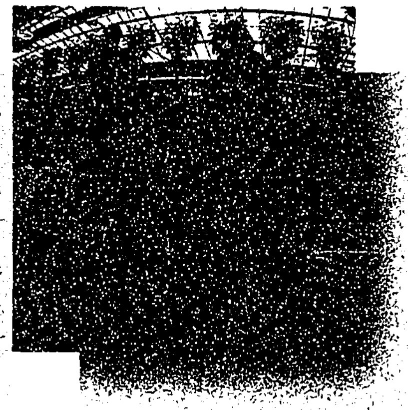
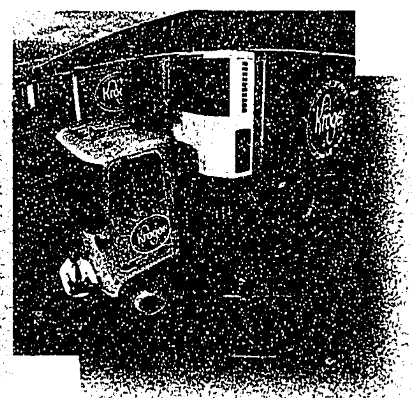
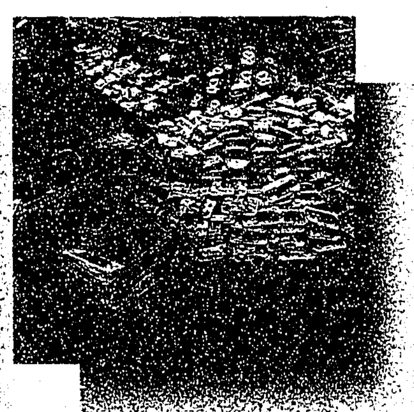
The Kroger Co. Annual Report 1981





1981 Financial Summary

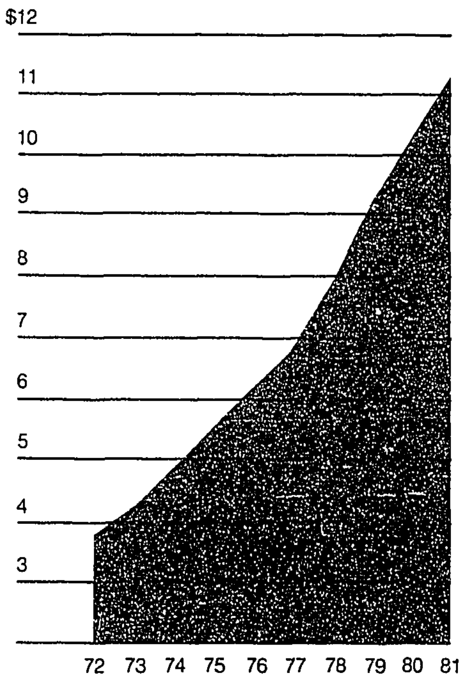
Sales and earnings of The Kroger Co. in 1981 increased for the sixth consecutive year.

Sales for 1981 (52 weeks) were $11.3 billion, up $950 million or 9.2% from sales of $10.3 billion for 1980 (53 weeks).

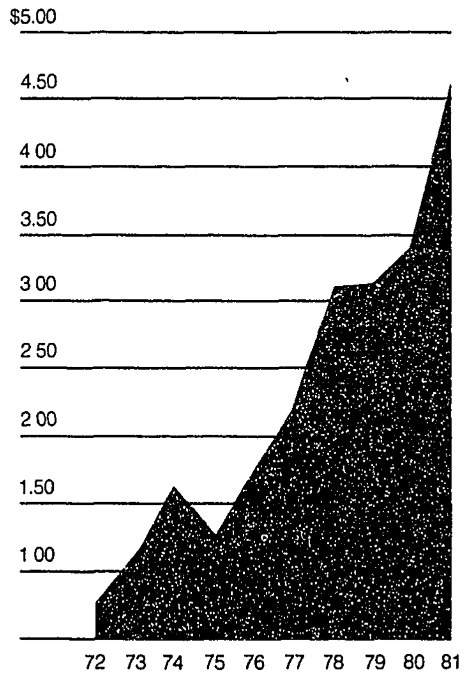
Earnings from continuing operations increased 26% over 1980. Earnings from continuing operations in 1981 were $129.5 million or $4.56 per share, compared to $102.8 million or $3.71 per share in 1980. Net earnings were $128.0 million or $4.51 per share, versus $94.4 million or $3.41 per share in 1980.

In line with Kroger's policy of sharing our progress with the owners of our business, the quarterly dividend was increased from 38¢ to 43¢ per share, effective with the December 1, 1981, payment. This brings the indicated annual dividend rate to $1.72 per share and represents the eighth increase in the past six years.

Sales (Billions)



Earnings Per Share (Dollars)



On the cover:

More than 127,000 dedicated Kroger men and women work to bring food and related items to America's dinner table. The customer is the central focus of all our efforts. Our cover pictures move through fields and greenhouses with our Wesco produce procurement team, and into a modern Kroger dairy. Products are quality-checked at every step of the way before they are carried by one of the nation's largest private truck fleets to the various departments in 1258 Kroger stores. In-store information to help customers shop more wisely, such as the Nutrition News program, lower left, is in all food stores.

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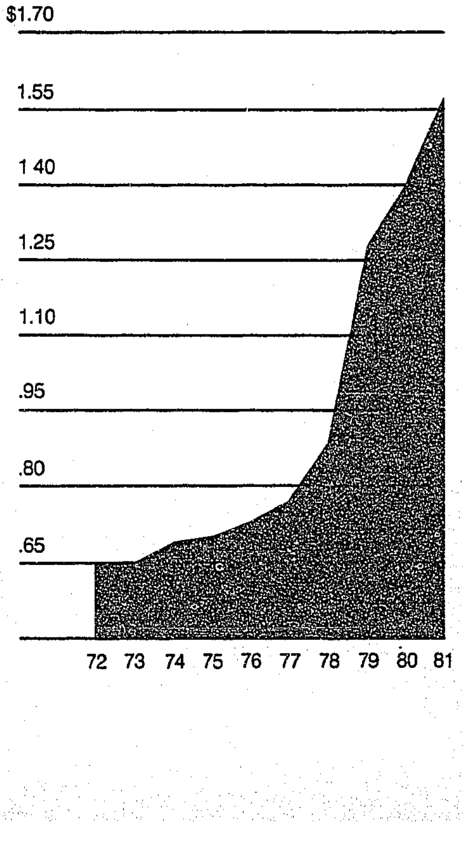
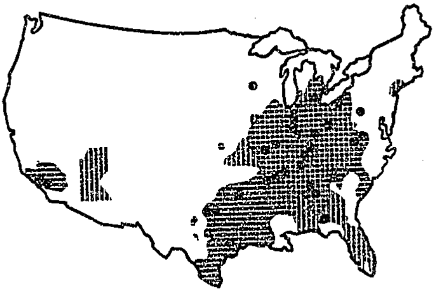
Dividends Per Share of Common Stock (Dollars)



Food Stores. The Kroger Co. is the fifth *largest retailing company in the United* States as ranked by total sales. The Company's largest operation is Kroger Food Stores, the second largest retail food chain, with 1258 food stores in 20 states at the end of 1981. Some 94% of food store square footage is new or remodeled in the past 10 years. Most of these improved facilities are in the large superstore or combination store category. More than two-thirds of the new stores in 1982 will be combination stores and more than half will be located in the Sunbelt.

Processing Facilities. Kroger also processes food for sale in its food stores, a tradition which began before the turn of the century. The Company operates 31 food processing plants, primarily serving the food stores. Included are nine bakeries and nine dairies, in addition to a cheese plant, egg grading and packing plants, a peanut butter plant, a candy plant, a pet foods plant, a delicatessen kitchen, a pharmaceutical plant and a general processing plant where such products as preserves, salad dressings and other items are processed.

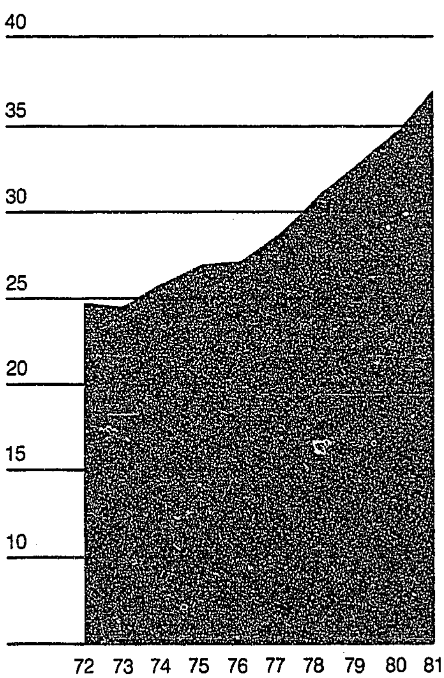
SupeRx Drug Stores. With 507 stores in 21 states at the end of 1981, SupeRx is one of the nation's largest drug store chains. Although SupeRx operates a majority of its drug stores in states where Kroger Food Stores are located, drug stores also are located in Arizona, Connecticut, Florida, New Jersey and New York. A major revitalization program, now under way, is converting the drug stores to the SupeRx II concept—health, personal care and convenience-oriented.



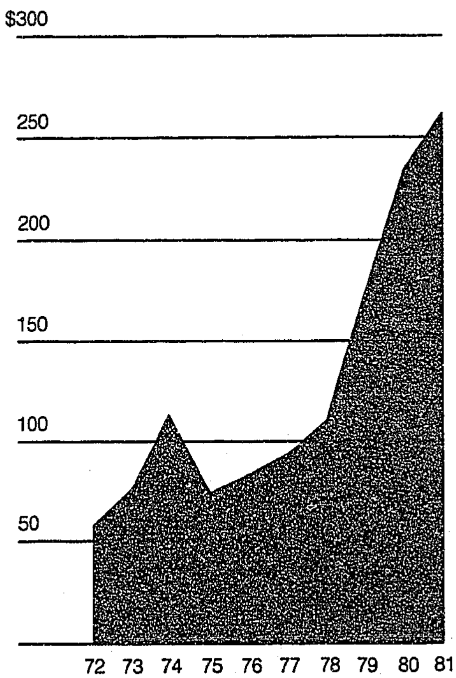
Financial Highlights

	1981	1980	Change
Sales	**$11.3 billion**	$10.3 billion	+ 9.2%
Earnings From Continuing Operations	**$129.5 million**	$102.8 million	+ 26.0%
Net Earnings	**$128.0 million**	$ 94.4 million	+ 35.7%
Earnings Per Share			
From continuing operations			
Primary	**$4.56**	$3.71	+ $.85
Fully diluted	**$4.43**	$3.71	+ $.72
Net earnings			
Primary	**$4.51**	$3.41	+ $1.10
Fully diluted	**$4.38**	$3.41	+ $.97
Dividends Paid on Common Stock	**$43.8 million**	$38.8 million	+ 12.9%
Per Share of Common Stock	**$1.57**	$1.40	+ $.17
Return on Average Equity	**17.3%**	14.7%	
Capital Expenditures	**$260.2 million**	$239.1 million	+ 8.8%
Real Estate Data			
Food stores			
Opened	**111**	118	
Remodeled	**57**	49	
Total area (sq. ft.)	**37.0 million**	34.5 million	
Drug stores			
Opened and acquired	**57**	42	
Remodeled	**15**	27	
Total area (sq. ft.)	**5.7 million**	5.8 million	

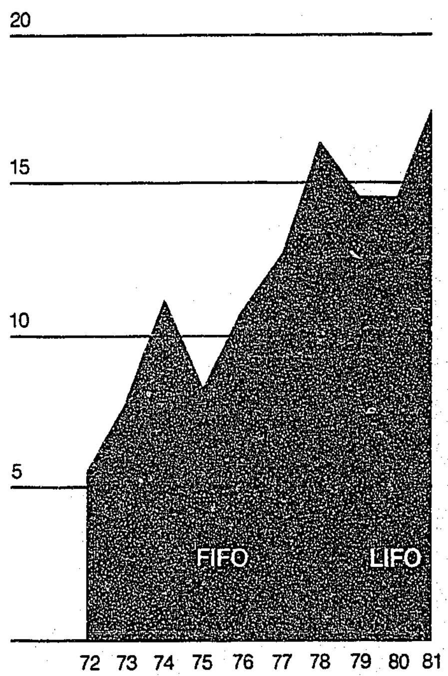
Food Store Square Footage (Millions)



Capital Expenditures (Millions)



Return on Average Shareowner Equity (Percent)



To our fellow shareowners

The Kroger Co. continued to grow in 1981, emphasizing again the many strengths and the versatility that have been built into the Company during the past decade.

This was the sixth consecutive year of sales and earnings increases. It demonstrated our ability to perform in varying economic climates as well as to meet the needs and demands of a growing number of shoppers.

The basic Kroger difference is plainly visible in our results. Our contemporary merchandising is responsive to the changing demographics of our customers. We have 127,271 talented people to implement our plans and possibly the best training and development programs in our industry. Our real estate program is aggressive and effective. Our manufacturing and private label programs offer values to our shoppers and profits to the Company. And we have a dedication to operating effectively in all areas—from the thoroughness with which we research a store site to the efficiency of our distribution operations to the sophistication of our financial planning. All of these efforts come together in a well-run retail store that demonstrates our commitment to our customers.

But the fundamental strength of Kroger comes from *listening* and *responding* to what customers are telling us.

We annually interview some 300,000 shoppers, asking them what they want to find in a supermarket...and how Kroger and our competitors meet their needs.

Our research led us to offer bulk produce...everyday low prices... variety...quality...service. Because of the continued growth in consumer preference for one-stop-shopping, we expect continued improvement in the return on our investment in service specialty shops.

The 42,000 square foot Kroger combination store of the 1980s offers a presentation filled with the kind of merchandising excitement that makes "going Krogering" an experience that shoppers want to repeat. In many of our markets, we have few, if any, competitors who offer the variety of specialty departments that Kroger does. Our combination stores offer up to 12 specialty departments —from fresh-cut flowers to pharmacies to service seafood to cosmetics.

Today's consumer has different needs and wants than the shopper we served in 1971 or in 1975. As our customers' needs change, Kroger evolves to keep pace.

The past 10 years have witnessed more change than any comparable period in our Company's history. During that decade, we have prepared ourselves for today—operating with long range as well as immediate needs in mind. We intend to be even more successful 10 years from now—and we will do it by keeping the Company modern, progressive and *responsive*.

1981 Was Significant Year

During 1981, we advanced in several key areas.

- We maintained our aggressive building program despite tightening of the money supply.
- Concentration of store development in those areas of the country that are experiencing dynamic growth, such as the South, continued.
- Our typical store of the '80s moved increasingly toward the large combination store, enhancing our ability to provide the one-stop-shopping service our customers want. We now operate 164 combination stores.
- Investment in productivity improvement accompanied our store development and our merchandising. We now have 312 food stores equipped with electronic scanner checkout systems and plan to add 133 in 1982—offering improved customer service, increased efficiency and a valuable information source. We also are seeing strong improvement in controlling distribution costs, which in 1981 were the lowest in the past 37 years as a percent to sales.
- Development of management information services was strengthened in 1981. Timeliness and quality of the information available is a key asset to management decision-making. Computer resources are becoming increasingly involved in the operation of our business. As we develop new information systems for Kroger management that support accomplishment of the Company's business objectives, we are enhancing our ability to make informed decisions promptly.
- Capital expenditures in 1981 totaled $260 million. During the 1981-83 period, our capital investments will total more than $1 billion. Capital monies will primarily be generated internally, but we also intend to take advantage of other forms of financing, such as pension fund real estate financing and sale and

leasebacks. The new tax laws, which are designed to encourage companies to invest to produce jobs and help the economy, will assist both our developers and the growing number of projects which Kroger develops itself.

• In keeping with our intention to dispose of our interest in the amusement park business, sale of our 50% interest in Marineland was completed in January, 1982. This represented our last holding in the amusement park business.

Kroger Food Processing

As our food store business grows, new opportunities are provided for improving quality and maximizing profitability by manufacturing the products we sell.

We continue to assess our needs and how best to supply them—our manufacturing operations evolve just as our retailing operations do. We make the decision to enter a new business only when it is clearly advantageous for us to manufacture the product ourselves.

The new Kentucky frozen dough bakery is now serving Kroger stores companywide and a new cheese plant in Indiana will be completed in late 1982. A new Tennessee dairy was opened during the year and construction of a new dairy in Kentucky is under way. Also planned for 1982 are a sugar-based products plant in Kentucky and an imported products plant in South Carolina.

Construction will begin in spring, 1982, on a whey conversion plant in Kentucky. And a new Research and Development Center will be built this year adjacent to Northern Kentucky State University.

SupeRx Drug Stores

SupeRx Drug Stores in 1981 had sales of $683 million, up 7.5% from the prior year. Pre-tax operating profits of $6.5 million were down 33.6% from 1980's $9.8 million. Pre-tax profits include a $4.3 million profit from the sale of 21 drug stores in Houston, Texas.

We are encouraged by the improvement that was evidenced throughout the year, although SupeRx results continued to reflect the cost of the revitalization program which thus far has converted 138 new and remodeled drug stores to the SupeRx II concept.

Gerald L. Wolken, formerly vice president of the Erie Marketing Area of Kroger Food Stores, has been elected a corporate vice president and named president and chief executive officer of SupeRx Drug Stores. George W. Keith has been named chairman of SupeRx.

We look forward to continued maturing of SupeRx in 1982.

1982—Year of Opportunity

In 1982, we plan to continue our investment in Kroger's future.

We expect our capital spending to be approximately $375 million this year. Plans call for 80 to 90 new food stores and remodeling of 90. Because we are opening larger stores and have more expansions of stores, total new square footage is expected to approximate 1981's 4.1 million square feet.

During this year, we expect to open 50 to 60 new and 25 remodeled SupeRx stores—preparing for the future contributions of our drug stores.

Edward D. Smith and R. Nelson Shaw are retiring from the Board of Directors and will not stand for reelection. Both have been valued members of the Board for many years—Mr. Smith for 27 years and Mr. Shaw since 1968. Their dedication and wise counsel through the years are much appreciated. John A. Cornett and William G. Kagler, senior vice presidents, have been nominated to succeed them.

Each new year presents new opportunities and new challenges. Kroger, through careful planning and imaginative implementation, is situated better than most in our industry to address both the opportunities and the challenges—and make them positive experiences for our Company, our customers, our employees and our shareowners. We look foward to the coming year with the satisfaction of knowing we have prepared ourselves. We are ready.

Sincerely,

Chairman of the Board and President

March 31, 1982

Kroger Management

Listening and Responding

"The *store* and an ever-growing constituency of *satisfied customers* is the key to the business success of The Kroger Co. Our principal objective is to be a profitable, performance-proven leader in food/drug retailing and manufacturing, with recognition coming from our customers, our shareowners, our employees and our industry."

1980 Kroger Annual Report

"The fundamental strength of Kroger comes from *listening* and *responding* to what customers are telling us."

Chairman's Letter, 1981 Kroger Annual Report

Kroger in 1981 continued to respond to the changing needs of the consumer, using our strengths in the fundamentals of our business. ...Everyday low prices. Strong emphasis on the departments such as produce, meat and dairy which are so important in achieving customer loyalty. Growth in special interest departments. Improvement of gross margin through changes in the mix of products sold. Strong real estate...effective employee training...financial discipline...

Our carefully-developed business plan is the constant backdrop against which Kroger makes operating and merchandising decisions. Without regular measurement of what we are achieving, Kroger would not be where it is today. And we would not hold promise of achieving better results in the future.

How does Kroger listen to consumers?

Shoppers vote for products every day in our stores by their purchases—but listening starts long before that. Kroger is a research-oriented organization. In a sense, Kroger has 300,000 consultants who help us run the business better.

These "consultants" are, of course, the 300,000 shoppers who were interviewed last year by our consumer researchers. We ask these men and women everything from what they like to find in a supermarket to how Kroger stacks up against other food stores to what sells them on shopping at a particular store.

Through the past decade, consumer research has proven its worth to Kroger many times over. Our formal consumer research in its modern sense began with a modest effort in the early '70s—innovative in our industry at the time. We interviewed 4,000 shoppers that first year—today this activity has grown to be one of the most sophisticated and complete in the United States.

When early research showed room for improvement in Kroger produce departments and a definite interest by consumers in being able to buy unpackaged fruits and vegetables, our merchandising people at first were skeptical. But the readings were strong enough that Kroger decided to test the concept—and the rest is merchandising history.

Every one of our specialty departments began with a clear indication of interest on the part of shoppers. But it doesn't end with consumer research.

Take the newest service specialty department in Kroger stores. In July, 1981, we opened our first nutrition and health food center in a Kroger store. At year-end, there were six centers; by the end of 1982, we expect to have 75.

Consumer research first showed us shopper interest in health food. We responded to that interest with eight months of research and study.

Our planners then combined the best of the health food stores and departments they had studied across the nation, added some new touches and blended all the ideas into a uniquely Kroger design.

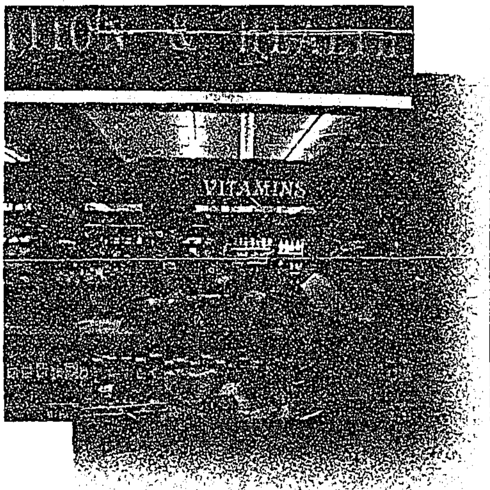
Even the products that we offer were planned for Kroger customers. Whereas nutrition and health food stores are usually heavily oriented to vitamins and supplements, Kroger's selection is heavily food-oriented—in keeping with our business.

We offer more than 1,000 items—everything from freshly squeezed orange juice to salt-free foods, vitamins, fruit-and-nut snack mixes, bulk grains and natural cosmetics. And an essential part of a department such as this—which is really a store within a store—is careful training of the employees who will be working directly with customers.

Personnel training and development—always a high priority at Kroger—has become a key factor in successful store operation, particularly since the development of superstores and combination stores demanded new skills and new management approaches.

The three Kroger Education Centers in Cincinnati, Atlanta and Houston

Quality of the fresh fruits and vegetables Kroger sells is checked from the farm, such as the Florida strawberry field shown at right above, to our modern produce departments.



provide specialized management training each year for some 3,000 Kroger men and women—most of whom are directly involved in running a store every day.

Kroger now is the world's largest florist and the largest operator of in-store delicatessens. The company today operates 1,009 delicatessens and 811 in-store fresh bakeries, as well as cheese, floral, service seafood and service meat shops, cosmetic/fragrance boutiques, pharmacies in food stores and sit-down restaurants. Ten years ago, Kroger had virtually none of these departments. All required the learning of new skills—and that meant new kinds of training for employees.

Kroger still utilizes programmed instruction manuals to augment on-the-job training. But 800 of the food stores each has a library of Kroger-developed instructional sound filmstrip cassettes which can be utilized right in the store at the employee's convenience and individual speed. This audiovisual training is enabling employees to learn new skills properly and quickly and it is enhancing their ability to serve shoppers better and please them more. Cassette programs cover everything from customer relations to how to trim a steak to how to decorate a cake or arrange a bouquet.

Specialty Departments Provide Ambience

The personality of a Kroger food store is enhanced by the various specialty departments—which add the zest, convenience and fun that makes Kroger stand out from an ordinary supermarket. We are finding more and more customers who want one-stop-shopping . . . who no longer have the time or the patience to make several stops to do their weekly shopping. And even though we usually sell at a lower price than more traditional outlets for many of these products, Kroger specialty departments are helping us to sell more of the products on which we make a better return . . . so we can hold down prices and yet improve gross margin.

'Kroger is the world's largest florist and the largest operator of in-store delicatessens'

These are not merely impulse-buying departments. Our research indicates that as customers become accustomed to this wider variety of merchandise, they add the flowers, imported cheese, perfume, baked foods and other specialty items to their shopping lists along with the soap powder and the canned peaches.

Bearing this out, sales in our service specialty departments are growing at a considerably faster rate than sales in other departments of the store.

As we broaden the choice of specialty items offered to shoppers, we also are giving more choice to the customer whose main interest is price.

Kroger does not carry generic or no-name brands. Our experience has shown that customers do not like inconsistent quality. They want and deserve to know what they are buying each time they make a purchase. As a result, we developed an addition to our private-label line which offers the same price savings as no-names, but with consistent, guaranteed quality.

The Cost Cutter brand, easily identified on the shelf by its colorful yellow, red and black label, was introduced during 1981 and has been extremely popular. There are now about 175 Cost Cutter brand products—ranging from plastic bags to canned peas to tuna. More will be added in 1982.

Growth of the specialty departments in our food stores also will continue in 1982. Delicatessens—bursting with luncheon meats and sausages of all descriptions, flanked by shimmering desserts and tangy salads made in our Indiana delicatessen kitchens—have become a basic part of a Kroger superstore. A total of 132 additional delicatessens will be added this year, for a total of 1141, along with a like number of in-store fresh bakeries, to bring the total to 943.

Growing demand and our insistence on high quality have led to new manufacturing operations, such as the 145,000 square foot frozen dough and hearth bread bakery which

opened last fall in Bowling Green, Kentucky. This unusual bakery is now providing the basic doughs which Kroger in-store bakers turn into a bounty of sweet-smelling bread, rolls, pastries and other popular baked goods.

The new Bowling Green bakery also is supplying Kroger stores companywide with crisp-crusted hearth-baked breads and rolls—steam-baked in huge, brick-lined ovens.

Kroger studied this project for a year and a half before embarking on providing its own frozen doughs. We must have sufficient volume, and we must be sure that making our own products will produce better and more consistent quality for our shoppers—along with increased profitability for our shareowners. Only then do we decide to *make* rather than *buy* a product.

The first Kroger full-line floral shoppe was opened just three years ago, although superstores had long offered green plants and seasonal flowering plants. By the end of 1982, we expect to add 223 floral shoppes for a total of 660 offering a full assortment of blooming and foliage plants, cut fresh flowers and arrangements, and dried and silk flowers.

The enthusiastic response of Kroger shoppers to floral shoppes is challenging our buyers. Strict quality control is just as important for floral products as it is for the other products we sell. Kroger has a built-in advantage, because the field inspectors and buyers from our Wesco produce procurement organization are right on the scene where many flowers are grown—and can make personal selection of high quality flowers.

But with our customers buying more flowers than could be obtained from existing outlets, our buyers must reach out around the world for a sufficient quantity of the best quality flowers. Flowers, for example, are being grown to our order across the U.S. and in some cases, are air-shipped to Kroger stores from Holland, Israel and South America to supplement supplies obtained from the nation's best floral growing centers.

Similarly, the popularity has outstripped the available supply in other areas of the store. The enthusiasm of customers for such items as white corn in our produce departments or for fresh farm-raised catfish in our seafood departments calls for new sources of supply. So acres of white corn of the quality our shoppers want and thousands of high-quality catfish are being grown to our order to meet the demand.

'Our annual fly-in of fresh Alaskan salmon for the 4th of July is fast becoming a tradition'

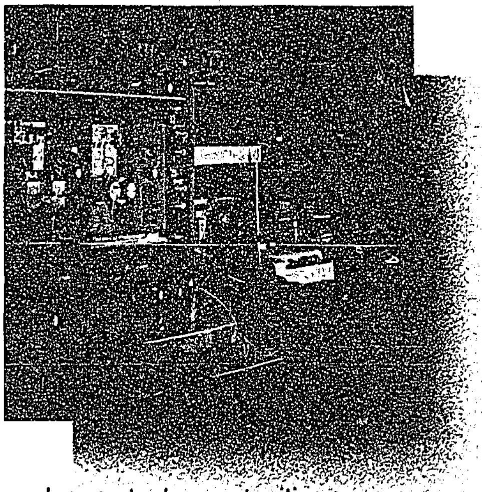
Seafood is another product that is growing in popularity throughout the country. Kroger now offers fresh seafood in all our stores... in many areas the first time that shoppers have tasted fresh, never-frozen seafood. Kroger's innovative marketing includes such events as our annual fly-in of fresh Alaskan salmon for the 4th of July weekend, which is fast becoming a tradition. In 1981, Kroger customers enjoyed in the neighborhood of 1½-million pounds of this delicacy. In many cities last summer, fresh salmon from Kroger was the status meal for the backyard grill! Service seafood shops also will grow in 1982. Plans call for adding 79, with 300 by the end of this year.

Also planned by the end of 1982 will be 137 additional cheese shops for a total of 519; 51 new service meat departments (185 total); 40 cosmetic/fragrance boutiques (total 155); 80 in-store pharmacies (adding up to 218), and 111 restaurants, for a total by year-end of 311.

As our food stores continue to increase in size and as we add and expand the specialty departments our customers want, there will be more intermeshing of plans of the retail stores and the manufacturing operations. The frozen dough bakery represented one such venture. Another is the new Indiana cheese plant—our second—which will open in mid-1983.

We also are seeing some changes in our manufacturing mix as some older products become less popular, as demand for new products enters the picture, and as the geographic center of our retail store locations shifts southward.

The new Tennessee dairy and the dairy in Kentucky, now under construction, will help meet the growing demand for service for Sunbelt stores. Because Kroger has among the most modern dairies in the country and has maintained and improved the top quality of Kroger dairy products, Kroger milk and other dairy items have risen in popularity even though the national



The new frozen dough and hearth-bread bakery in Kentucky supplies in-store bakeries. Left above, the Indiana delicatessen kitchen prepares tasty salads and desserts for store delicatessens. Right, research and development is an integral part of our manufacturing operations.

consumption trend is down. Convenient location of dairies becomes even more important as the cost of transporting milk increases. And the efficiencies of larger, more modern plants can have a dramatic effect on operating costs.

As announced previously, Kroger will be moving toward a larger number of more specialized plants located closer to the source of supply and to the geographic center of the stores they serve.

For example, the new imported products plant which will open this year is approximately 500 miles closer to the eastern ports where such products as tea, coffee and spices are received. The sugar-based products plant in Kentucky, where gelatin, drink mixes and salted nuts will be processed, also set for a 1982 opening, is located near Mississippi River and Kentucky Lake ports and provides access to either cane or beet sugar by rail, truck or boat.

Kroger brand products now are distributed internationally with the introduction of more than 100 items to 260 Daiei stores in Japan. In August, Daiei superstores added a new department—imported Kroger products in a red-white-and-blue-decorated booth. Distribution also has begun to 1000 Daiei-affiliated stores in Japan. Our supplying of products to these stores is the first step in a cooperative arrangement announced at the beginning of last year, when The Daiei, Inc., Japan's largest food and general merchandise retailer, and Kroger announced agreement to explore mutual opportunities.

The research and development activities of our Kroger manufacturing team have sparked two new developments.

Construction will begin this spring on a whey conversion plant in Kentucky in partnership with Corning Glass Works. The joint venture will couple Corning-developed technology for converting whey into a sweet syrup called hydrolyzed lactose with Kroger-developed fermentation technology for converting the syrup into bakers' yeast. Whey from Kroger dairies—a waste by-product of cheese processing—will be converted into bakers' yeast to provide the needs of Kroger bakeries. Syrup and whey protein concentrate produced by the plant also will be utilized by Kroger in its processing operations. This will be the first commercial application of converting whey, which has posed an expensive disposal problem for dairies, into bakers' yeast.

'In 1982, Kroger plans to open 80 to 90 new food stores, along with 90 remodels'

Ground will be broken in the spring of 1982 for a new 62,000 square foot Research and Development Center adjacent to Northern Kentucky State University in northern Kentucky—providing modern, expanded facilities for this important aspect of our operation. The Center will be responsible for both product and process development activities.

Store Development Strong

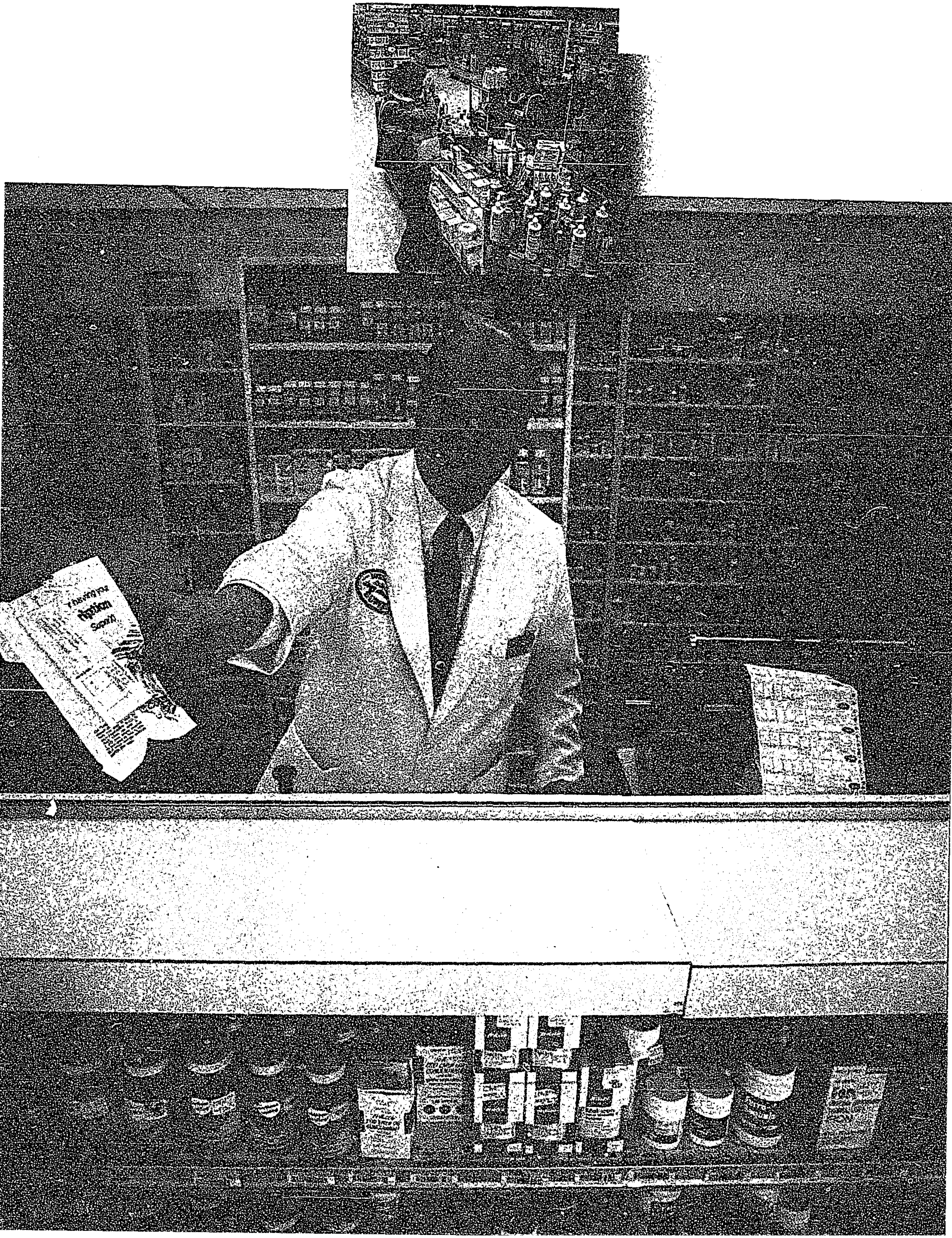
The Kroger Food Store of the 1980s is growing rapidly in size. The 111 new stores opened in 1981 averaged 36,758 square feet in size. Forty of these new stores were 42,000 square-foot-or-larger combination food, drug and general merchandise stores. And all new stores contain a variety of the specialty departments that have proven so popular with shoppers. In addition, about half the 57 remodels completed during 1981 were enlargements, the majority moving from superstores to combination stores. At the same time, we closed or sold 98 stores.

In 1982, Kroger plans to open 80 to 90 new food stores, along with 90 remodels. More than two-thirds of the new stores this year will be in the large combination store category, with the average size to be opened rising to 39,000 square feet. More than half will be located in the South.

In Dallas, 11 former Treasury drug stores which are adjacent to Kroger superstores were purchased late in 1981, and are being combined with the food store space to produce combination stores that will compare with the finest in the Dallas market. In Houston, six former SupeRx stores will be utilized for similar conversions.

SupeRx Drug Stores

During 1981, SupeRx continued to revitalize its merchandising and increase the efficiency of its operations. We are seeing progress in both areas.



While the cost of such a massive changeover will continue to impact on SupeRx earnings, the drug stores demonstrated a growing strengthening of results each quarter through 1981.

During the year, SupeRx opened 57 new stores, remodeled 15 and closed or sold 64, bringing the year-end total to 507. There are now 138 new and remodeled SupeRx II stores and we expect to have more than 200 in the new concept by the end of 1982—approximately 40% of our drug stores.

SupeRx long-range plans will be aimed at strengthening our representation in key markets to enable the drug stores to support advertising and other key services that are vital to a successful operation.

Movement of SupeRx into supplying stores through central distribution centers is expected to have a favorable impact on merchandise costs. Stores in the Southeast are presently served by the Florida warehouse operated by our non-foods distributing subsidiary. When the expansion of the Tennessee non-foods warehouse is completed, some 330 SupeRx stores will be warehouse-supplied. And with the opening of a third non-foods distribution center, tentatively scheduled for 1983, approximately 90% of SupeRx stores will be served through warehouses.

Consumer research also is being utilized at SupeRx to pinpoint trends, opportunities and problem areas.

Left, pharmacy remains the heart of a SupeRx drug store, while expanded services such as the cosmetics department shown at top add to the convenience of shopping at SupeRx.

Consumers perceive the SupeRx II stores as superior in such areas as variety, quality, pricing and service.

As the SupeRx II concept develops, some merchandising refinements are being made to accommodate the needs of the customers of each store. While the overall store remains health, personal care and convenience-oriented, departments may be added to enlarge the store's usefulness and appeal to the community. For example, a basic assortment of housewares, sewing notions or hardware may be extremely important to shoppers at one store, even though they are not suitable for other stores. In other areas, an expanded health foods department or added convenience and party foods might be more meaningful.

'Consumer research also is being utilized at SupeRx to pinpoint trends, opportunities and problems'

Throughout the company, SupeRx is operating with more flexibility but with more control—responding to local conditions but exerting control in the important areas of procurement and merchandising strategies. There is still a big job to be accomplished in SupeRx, but the direction has been established, the people are being developed, and the merchandising and the operating efficiencies that can produce results are being implemented.

Corporate Responsibility

At Kroger, we take seriously our corporate social responsibility to help maintain a reasonable quality of life in the communities we serve. We undertake to meet that responsibility both through the personal involvement and service of many Kroger people and through an organized program of corporate charitable contributions.

In 1981, The Kroger Co. made contributions to non-profit charitable organizations totaling $1,126,000. Nearly 60% of this amount was given to United Way campaigns in the 700 communities in which we operate. The balance of our charitable contributions went to health and welfare, cultural, educational and civic groups, with special emphasis on consumer and nutrition education projects.

In addition to our formal corporate contributions program, the various operating units of the Company donated cash or products totaling $537,000 to support worthwhile community activities and events.

The combined total of the two facets of our contributions program was $1,663,000, representing .85% of our pre-tax earnings.

Management's Discussion and Analysis of Financial Condition and Results of Operations

This analysis of Company operations encompassing the years 1979, 1980 and 1981 should be considered in conjunction with the Consolidated Balance Sheet, pages 16-17, the Consolidated Statement of Earnings, page 18, the Consolidated Statement of Changes in Financial Position, page 19, Operating Results by Segments of Business, page 22, and the Ten Year Summary, pages 34-35.

Liquidity and Capital Resources

Capital expenditures and dividends have required $794.3 million of funds over the past three years. Of this amount, $644.8 million has been provided from operations. The balance of required funds has come primarily from long-term financing arrangements. The 1981 arrangements included the sale of $50 million in convertible subordinated debentures, issuance of $50 million of convertible preferred stock, and the sale of $50 million in ten year notes and $72 million in industrial revenue bonds. The Company had $281 million in cash and short-term investments at January 2, 1982, approximately $200 million of which is in anticipation of future requirements for capital spending.

Sources of Funds in Millions

	Operations	Other	Total
1981	$253 9	$279 8	$ 533.7
1980	220.1	89.2	309.3
1979	170.8	36.3	207 1
Three years	$644 8	$405 3	$1,050 1

Capital spending plans for the 1981-1983 period total more than $1 billion. The Company anticipates that additional funds required to support these expansion plans will come primarily from operations plus external pension fund real estate financing, sale and lease-backs, and other long-term financing arrangements.

Capital expenditures in 1981 were $260.2 million, which was $21.1 million higher than in 1980 and $83.3 million higher than in 1979. In 1982, capital spending is expected to be approximately $375 million. Plans include 80 to 90 new food stores, 50 to 60 new drug stores, the remodel of 90 food stores and 25 drug stores, plus additional manufacturing and distribution support facilities. Company ownership of store properties has increased somewhat during the past year and will continue to increase due to the present condition of financial markets, limited availability of funds for developers, and tax advantages under the 1981 Economic Recovery Tax Act.

Summary of Retail Expansion

	1981	1980	1979
Food Stores.			
Opened	111	118	88
Remodeled	57	49	91
Closed or Sold	98	107	56
Stores—End of Year	1,258	1,245	1,234
Total Area*	36,985	34,529	32,460
Drug Stores.			
Opened or Acquired	57	42	38
Remodeled	15	27	2
Closed or Sold	64	32	21
Stores—End of Year	507	514	504
Total Area*	5,715	5,841	5,657

*In thousands of square feet

At January 2, 1982, the Company had available a revolving credit aggregating $100 million against which it may obtain interim loans until May, 1983. At the Company's request, the interim loans may be converted into a term loan payable over four years. Also, the Company had available lines of credit amounting to $23.2 million. In addition, the Company had commitments for real estate and equipment financing from pension funds and banks for $130 million.

In spite of the increased amount of long-term debt and capitalized lease obligations as a percent of long-term capitalization (Long-Term Debt + Capitalized Lease Obligations + Shareowners' Equity), the pre-tax earnings coverage of interest and rents has remained stable as illustrated below:

	Percent of Long-Term Capitalization		
	1981	1980	1979
Senior Debt	27 3%	25.4%	24.6%
Subordinated Debt	3 7	—	—
Capitalized Lease Obligations	9.8	11 1	11.1
Total	40 8%	36.5%	35.7%
Pre-Tax Coverage of Interest and Rents (times)	2.02	1.98	2 03

Working Capital at year-end 1981 increased by $154.3 million. Cash and temporary cash investments increased by $188.4 million primarily as the result of the timely long-term financing arrangements which were completed during the second half of the year. Short-term borrowings averaged $16.4 million during 1981 compared to $8.9 million in 1980; however there was no outstanding short-term debt at the end of 1981. Average (FIFO) inventory turns remained at 9.5 in 1981 compared to 9.5 in 1980 and 9.2 in 1979 despite higher inventory levels in new combination food stores and new manufacturing operations which indicates improved results in our stores and plants opened prior to 1981.

Results of Operations

Consolidated sales in 1981 (52 weeks) of $11.3 billion increased 9.2% over 1980 (53 weeks). Consolidated sales on a comparable 52 week basis would have increased 11.5% over 1980. Food store sales in 1981 of $10.6 billion increased 9.3% over 1980 (52 weeks vs. 53 weeks) and drug store sales of $683 million were 7.5% over 1980 (52 weeks vs. 53 weeks).

Consolidated Sales (in millions)

	1981		1980		1979	
	Amt.	Chg	Amt	Chg	Amt.	Chg.
Food Stores	$10,584	+9.3%	$ 9,682	+14.4%	$8,462	+15 8%
Drug Stores	683	+7.5%	635	+12 0%	567	+ 8.6%
Total	$11,267	+9 2%	$10,317	+14.3%	$9,029	+15 3%

Food store prices increased in 1981 by 6.8% compared to 9.0% in 1980. Tonnage improved 2.6% in 1981 from 1980 (52 weeks vs. 53 weeks) compared to a 5.1% increase in 1980 from 1979 (53 week vs. 52 weeks). On a comparable 52 week basis, 1981 tonnage would have increased by 4.5% from 1980. Food store sales volume was favorably influenced by expanded food store square footage and additional customer transactions.

Drug store sales in 1981 were affected by an approximate 10% increase in prices. Square footage and customer transactions declined slightly due to the fewer number of stores.

Merchandise costs, including warehousing and transportation, as a percent of sales have trended downward over the past three years to 76.7% in 1981 from 78.1% in 1979. Approximately 72% of the inventories for 1981 and 68% of the inventories for 1980 were valued using the last-in, first-out (LIFO) method. The 1981 LIFO charge to inventories, which was $30.5 million compared to $50.4 million in 1980, declined primarily as the result of a lower level of cost increases in 1981. Supplementary first-in, first-out (FIFO) information is presented below to facilitate comparisons to various other companies.

LIFO Effect on Merchandise Costs as a Percent of Sales
(in millions)

	1981		1980		1979	
	Amt	% Sales	Amt	% Sales	Amt.	% Sales
Mdse. Costs (FIFO)	$8,615	76.4	$7,962	77 2	$7,019	77 7
LIFO Charge	30	.3	50	5	37	4
Mdse. Costs (LIFO)	$8,645	76.7	$8,012	77 7	$7,056	78 1

Food store merchandise costs, including warehousing and transportation, were 77.1% of sales in 1981 compared to 78.2% in 1980 and 78.8% in 1979. The changes reflect a change in product mix in stores because of more specialty departments and additional nonfoods/general merchandise departments.

Drug store merchandise costs, including warehousing and transportation, were 70.9% of sales in 1981 compared to 69.4% in 1980 and 68.1% in 1979. This is primarily the result of more competitive pricing resulting in lower margins in the SupeRx II stores. At year-end, 138 stores or 27% of the drug stores were operating under the SupeRx II concept.

Operating, general and administrative expenses increased 13.0% over 1980 (52 weeks vs. 53 weeks). These expenses as a percent of sales increased to 19.1% in 1981 from 18.4% in 1980 and 18.0% in 1979. This increase was due primarily to higher employee related costs which increased 12.5% over 1980 and energy costs which increased 16.2% over 1980.

Operating profit for the food business (before taxes based on income and unallocated expenses) was $238.7 million in 1981 compared to $194.3 million in 1980 and $166.7 million in 1979.

Operating profit (before taxes based on income and unallocated expenses) for drug stores of $6.5 million declined from $9.8 million in 1980 and $12.8 million in 1979. Operating profit for 1981 included a $4.3 million gain resulting from the sale of 21 drug stores in Houston. Operating results continue to be impacted by the aggressive SupeRx II storing program. While the storing program represents an investment in the future, the Company has been encouraged by a strengthening of results each quarter through the year.

Net Earnings

Earnings from continuing operations increased to $129.5 million in 1981 (52 weeks) from $102.8 million in 1980 (53 weeks). Net earnings in 1981 were reduced $1.4 million to reflect the adjustment from estimated to actual costs of disposal of the Company's interest in the amusement park business.

Earnings from continuing operations on a FIFO basis were $145.9 million in 1981 compared to $130 million in 1980 and $105.5 million in 1979. Earnings from continuing operations increased 12.3% on a FIFO basis from 1980.

Although the rate of inflation has slowed, the high rates of inflation in recent years have impacted the Company's reported sales, earnings, shareowners' equity, and other financial data. An estimation and evaluation of the effect of inflation, as defined by Statement of Financial Accounting Standards No. 33, Financial Reporting and Changing Prices, follows on pages 30-32.

Management's Responsibility for Financial Reporting

The consolidated financial statements of The Kroger Co. and Consolidated Subsidiary Companies as well as other financial information contained in this report were prepared by management which is responsible for their integrity and completeness. These statements were prepared in conformity with generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

The Company has over the years maintained a system of internal accounting controls to provide reasonable assurance that Company assets are adequately protected, and transactions are executed in accordance with management's authorizations and are reflected accurately in the Company's books and records as a basis for the reliable preparation of the financial statements. The system of controls includes careful selection and training of financial management personnel, clearly defined limits of authority and division of responsibility, the dissemination of detailed formal accounting and business policies and procedures and an extensive program of internal audit examinations to monitor the effectiveness of the control system. The Company has distributed to key employees its policies requiring high moral, ethical and legal standards in the conduct of its business.

Coopers & Lybrand, certified public accountants, have examined the consolidated financial statements in accordance with generally accepted auditing standards. Their report on the consolidated financial statements appears on page 30.

The Board of Directors acting through its Audit Committee, which is comprised entirely of outside directors, oversees the fulfillment by management of its responsibilities in the preparation of financial statements and financial control. The Committee recommends the selection of the Company's certified public accountants, reviews the scope and costs of the internal and external audit programs and meets formally three times per year with the internal and external auditors, providing them direct free access at these and other times.

Consolidated Balance Sheet (In thousands of dollars)

Assets	January 2, 1982	January 3, 1981
Current Assets		
Cash and temporary cash investments	$ 281,257	$ 92,872
Receivables	96,935	95,334
Inventories:		
FIFO cost	928,489	862,341
Less LIFO reserve	(117,543)	(87,073)
	810,946	775,268
Property held for resale	25,275	
Prepaid and other current assets	63,928	78,931
Total current assets	1,278,341	1,042,405
Notes receivable	15,059	4,341
Investments		
Marketable investment securities	15,772	17,476
Investments in operations to be discontinued		23,873
Other investments	25,177	7,581
Total investments	40,949	48,930
Property, Plant and Equipment		
Land	40,468	32,811
Buildings and land improvements	207,563	168,662
Equipment	901,842	783,754
Leaseholds and leasehold improvements	275,233	237,321
Leased property under capital leases	173,480	152,866
	1,598,586	1,375,414
Allowance for depreciation and amortization	(545,822)	(490,797)
Property, plant and equipment, net	1,052,764	884,617
Excess of cost of investments in consolidated subsidiaries over equities in net assets	18,177	18,201
Total Assets	$2,405,290	$1,998,494

The accompanying notes are an integral part of the consolidated financial statements.

Liabilities	January 2, 1982	January 3, 1981
Current Liabilities		
Current portion of long-term debt	$ 3,281	$ 6,080
Current portion of obligations under capital leases	4,193	3,741
Notes payable		14,700
Accounts payable	589,100	504,334
Accrued expenses:		
Salaries and wages	122,704	110,188
Taxes, other than income taxes	105,918	98,578
Other	42,934	45,114
Accrued income taxes	13,966	17,766
Total current liabilities	882,096	800,501
Other Liabilities		
Long-term debt:		
Senior debt	372,816	268,146
Convertible subordinated debt	50,000	
Obligations under capital leases	134,523	117,819
Deferred federal income taxes	135,253	114,675
Employees' benefit fund	23,131	25,987
Total other liabilities	715,723	526,627
Total Liabilities	1,597,819	1,327,128

Shareowners' Equity		
Preferred capital stock, Cumulative, voting, par $100 Authorized: 5,000,000 shares Issued: 1981 — 500,000, 9% Series B shares 1980 — None	50,000	
Common capital stock, par $1, at stated value Authorized: 50,000,000 shares Issued: 1981 — 28,280,429 shares 1980 — 28,142,872 shares	100,083	96,748
Accumulated earnings	673,740	590,429
	823,823	687,177
Common stock in treasury, at cost — 1981 — 287,873 shares 1980 — 370,401 shares	(4,509)	(5,672)
Net unrealized loss on marketable equity securities	(11,843)	(10,139)
Total Shareowners' Equity	807,471	671,366
Total Liabilities and Shareowners' Equity	$2,405,290	$1,998,494

Consolidated Statement of Earnings (In thousands of dollars, except per share amounts)

Years Ended January 2, 1982, January 3, 1981 and December 29, 1979

	1981 (52 Weeks)	1980 (53 Weeks)	1979 (52 Weeks)
Sales	**$ 11,266,520**	$ 10,316,741	$ 9,029,315
Costs and Expenses:			
Merchandise costs, including warehousing and transportation	**8,645,000**	8,011,872	7,056,035
Operating, general and administrative expenses	**2,147,569**	1,901,178	1,625,974
Rent	**144,002**	130,632	112,527
Depreciation and amortization	**103,816**	86,166	71,574
Dividend and interest income	**(13,934)**	(11,403)	(12,688)
Interest expense, including interest on obligations under capital leases	**45,778**	35,736	29,385
Total	**11,072,231**	10,154,181	8,882,807
Earnings from continuing operations before taxes based on income	**194,289**	162,560	146,508
Taxes based on income	**64,805**	59,774	60,787
Earnings from continuing operations	**129,484**	102,786	85,721
Loss from discontinued operations	**(1,439)**	(8,400)	
Net earnings	**$ 128,045**	$ 94,386	$ 85,721
Earnings (loss) per share:			
Primary:			
From continuing operations	**$4.56**	$3.71	$3.13
From discontinued operations	**(.05)**	(.30)	
Net earnings	**$4.51**	$3.41	$3.13
Fully diluted:			
From continuing operations	**$4.43**	$3.71	$3.13
From discontinued operations	**(.05)**	(.30)	
Net earnings	**$4.38**	$3.41	$3.13

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Changes in Financial Position (In thousands of dollars)

Years Ended January 2, 1982, January 3, 1981 and December 29, 1979

	1981 (52 Weeks)	1980 (53 Weeks)	1979 (52 Weeks)
Sources of Working Capital			
From operations:			
Net earnings	**$ 128,045**	$ 94,386	$ 85,721
Loss from discontinued operations	**1,439**	8,400	
Earnings from continuing operations	**129,484**	102,786	85,721
Charges to earnings not involving funds:			
Depreciation and amortization	**103,816**	86,166	71,574
Provision for deferred federal income taxes	**20,578**	13,091	13,472
Tax benefit from discontinued operations		18,000	
Loss on marketable investment securities		94	
Total from operations	**253,878**	220,137	170,767
Preferred stock issued	**50,000**		
Common stock issued	**1,937**	1,227	1,952
Additions to long-term debt	**172,410**	62,350	23,163
Additions to obligations under capital leases	**21,893**	15,596	3,996
Net book value of fixed asset disposals	**11,126**	9,981	7,218
Reduction in investments in operations to be discontinued	**22,434**		
Total sources	**533,678**	309,291	207,096
Uses of Working Capital			
Cash dividends paid to shareowners	**44,734**	38,768	34,524
Capital expenditures	**260,218**	239,130	176,933
Increase in leased property under capital leases	**21,893**	15,596	3,996
Increase in notes receivable	**10,718**	4,341	
Reduction of long-term debt and obligations under capital leases	**22,929**	31,973	16,035
Deferred taxes due resulting from change to LIFO			16,811
Increase in other investments	**17,596**		
Other changes, net	**1,249**	2,116	2,937
Total uses	**379,337**	331,924	251,236
Net increase (decrease) in working capital	**$ 154,341**	$ (22,633)	$ (44,140)

Analysis of Working Capital Changes

	Increase (Decrease)		
Current asset changes:			
Cash and temporary cash investments	**$ 188,385**	$ 17,638	$ (58,234)
Inventories	**35,678**	(5,430)	83,371
Other current assets	**11,873**	58,788	4,076
Net increase in current assets	**235,936**	70,996	29,213
Current liability changes:			
Current portion of debt obligations	**(17,047)**	1,287	16,651
Accounts payable	**84,766**	37,036	50,908
Accrued expenses and taxes	**13,876**	55,306	5,794
Net increase in current liabilities	**81,595**	93,629	73,353
Net increase (decrease) in working capital	**$ 154,341**	$ (22,633)	$ (44,140)

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statement of Shareowners' Equity (in thousands of dollars)

Years Ended January 2, 1982, January 3, 1981 and December 29, 1979

	Preferred Stock Issued	
	Shares	Amount
Balance, December 30, 1978		
Net earnings for the year		
Dividends on common stock, $1.26 per share		
Exercise of stock options		
Increase in net unrealized loss on marketable equity securities		
Stock issued for acquisition of minority interest		
Tax benefit from exercise of non-qualified stock options		
Balance, December 29, 1979		
Net earnings for the year		
Dividends on common stock, $1.40 per share		
Exercise of stock options		
Decrease in net unrealized loss on marketable equity securities		
Stock contributed to employee stock ownership plan		
Tax benefit from exercise of non-qualified stock options		
Dividends reinvested under stock purchase plan		
Balance, January 3, 1981		
Net earnings for the year		
Issuance of preferred capital stock	500,000	$ 50,000
Dividends on preferred stock		
Dividends on common stock, $1.57 per share		
Exercise of stock options		
Increase in net unrealized loss on marketable equity securities		
Stock contributed to employee stock ownership plan and others		
Tax benefit from exercise of non-qualified stock options		
Dividends reinvested under stock purchase plan		
Balance, January 2, 1982	500,000	$ 50,000

The accompanying notes are an integral part of the consolidated financial statements

Common Stock						
Issued		In Treasury		Accumulated Earnings	Valuation Allowance	Total Shareowners' Equity
Shares	Amount	Shares	Amount			
27,842,106	$ 91,898	(580,454)	$ (9,658)	$483,614	$ (11,347)	$554,507
				85,721		85,721
				(34,524)		(34,524)
196,081	1,952					1,952
					(351)	(351)
	295	153,794	3,124			3,419
	604					604
28,038,187	94,749	(426,660)	(6,534)	534,811	(11,698)	611,328
				94,386		94,386
				(38,768)		(38,768)
89,680	903					903
					1,559	1,559
	417	56,259	862			1,279
	355					355
15,005	324					324
28,142,872	96,748	(370,401)	(5,672)	590,429	(10,139)	671,366
				128,045		128,045
						50,000
				(963)		(963)
				(43,771)		(43,771)
103,154	1,116	(15,474)	(371)			745
					(1,704)	(1,704)
	629	98,002	1,534			2,163
	769					769
34,403	821					821
28,280,429	$ 100,083	(287,873)	$ (4,509)	$ 673,740	$ (11,843)	$ 807,471

Segments of Business

The Company's segments of business information for the years 1979 through 1981 were:

	1981 (52 Weeks)	1980 (53 Weeks) (In millions of dollars)	1979 (52 Weeks)
Sales:			
Food Business	$ 10,584	$ 9,682	$ 8,462
Drug Stores	683	635	567
	$ 11,267	$ 10,317	$ 9,029
Operating Profit:			
Food Business	$ 238.7	$ 194.3	$ 166.7
Drug Stores	6.5 (a)	9.8	12.8
	245.2	204.1	179.5
Unallocated Expenses:			
Corporate expenses, net	5.1	5.8	3.6
Interest expense	45.8	35.7	29.4
	50.9	41.5	33.0
Earnings from continuing operations before taxes based on income	194.3	162.6	146.5
Taxes based on income	64.8	59.8	60.8
Earnings from continuing operations	$ 129.5	$ 102.8	$ 85.7
Identifiable Assets:			
Food Business	$ 1,921.4	$ 1,634.8	$ 1,369.6
Drug Stores	203.0	208.6	204.5
Other unallocated	280.9	155.1	212.6
	$ 2,405.3	$ 1,998.5	$ 1,786.7
Capital Expenditures:			
Food Business	$ 234.0	$ 224.5	$ 155.4
Drug Stores	$ 15.8	$ 13.2	$ 10.9
Depreciation and Amortization:			
Food Business	$ 96.6	$ 80.0	$ 66.0
Drug Stores	$ 5.2	$ 4.3	$ 3.5

(a) Drug Stores Operating Profit includes a gain of $4 3 million resulting from the sale of 21 stores

Quarterly Data (unaudited)

Quarterly sales, merchandise costs (including warehousing and transportation), net earnings and net earnings per share for 1981 and 1980 were:

Quarter	Sales In Millions 1981	Sales In Millions 1980	Merchandise Costs In Millions 1981	Merchandise Costs In Millions 1980	Net Earnings in Millions 1981	Net Earnings in Millions 1980	Earnings Per Share 1981 Primary	Earnings Per Share 1981 Fully Diluted	Earnings Per Share 1980 Primary and Fully Diluted
1st (12 Weeks)	$ 2,483	$ 2,189	$1,917	$1,710	$ 16.3	$12.4	$ .59	$ .59	$ .45
2nd (12 Weeks)	2,589	2,289	1,991	1,767	28.6	27.0	1.02	.98	.98
3rd (16 Weeks)	3,453	3,121	2,658	2,425	30.5	25.4	1.09	1.05	.91
4th (12 Weeks in 1981) (13 Weeks in 1980)	2,742	2,718	2,079	2,110	52.6	29.6	1.79	1.70	1.07
Total	$11,267	$10,317	$8,645	$8,012	$128.0	$94.4	$4.51	$4.38	$3.41

— 1981 earnings per share for a quarter is based on the average number of shares outstanding during the quarter. Earnings per share for the year 1981 is based on an average of each quarter's average of shares outstanding and may not equal the sum of each quarter's earnings per share.

— 1981 net earnings were reduced $786,000 in the third quarter (3¢ per share) and $653,000 in the fourth quarter (2¢ per share) for losses resulting from the disposal of the Company's investments in the amusement park business. 1980 net earnings were reduced $8.4 million in the fourth quarter (30¢ per share) for estimated losses resulting from the Company's decision to dispose of its investments in the amusement park business.

— The above earnings per share figures give effect to the Company's adoption of the provisions of Statement of Financial Accounting Standards No. 55, Determining whether a Convertible Security is a Common Stock Equivalent, for fiscal 1981.

The LIFO method of valuing inventories reduced net earnings as follows:

(In thousands of dollars except per share figures)

	1981 Net Earnings	1981 Earnings Per Share	1980 Net Earnings	1980 Earnings Per Share
1st Quarter	$ 6,072	$ .22	$ 4,561	$ .16
2nd Quarter	5,764	.21	6,547	.24
3rd Quarter	7,532	.27	8,970	.33
4th Quarter	(2,914)	(.10)	7,147	.25
	$16,454	$ .58	$27,225	$ .98

Common Stock Price Range

	1981 High	1981 Low	1980 High	1980 Low
1st Quarter	27¼	19¼	19	15
2nd Quarter	27⅞	23	20¼	14
3rd Quarter	25⅛	19¼	23¾	19½
4th Quarter	27⅛	21¼	22⅜	19⅞

Dividends Paid Per Share of Common Stock

Date Paid	1981	1980
March 1	$ .38	$ .34
June 1	.38	.34
September 1	.38	.34
December 1	.43	.38
	$1.57	$1.40

Main trading market — New York Stock Exchange
(Symbol KR)

Number of shareowners at year end
1981 — 37,549
1980 — 38,190

Notes to Consolidated Financial Statements

All amounts are in thousands of dollars except per share amounts.

Accounting Policies

The following is a summary of the significant accounting policies followed in preparing the financial statements which are not presented elsewhere in the notes. These policies conform to generally accepted accounting principles and have been consistently applied.

Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries. Certain partially-owned affiliated companies are included in the financial statements on the equity basis. Certain amounts in the financial statements for prior years have been reclassified to conform to the 1981 presentation.

Marketable Investment Securities

Marketable investment securities consist of bonds, notes, and common and preferred stocks held for investment. Dividend and interest income are accrued as earned. The cost of marketable investment securities sold is determined on the specific identification method.

Marketable equity securities (common and preferred stocks) are carried at the lower of cost or market. A valuation allowance, representing the excess of cost over market of these equity securities, is included in shareowners' equity. Other marketable investment securities (bonds and notes) are carried at cost unless there is a permanent impairment of value at which time the securities are valued at market. In management's opinion there is no indication of a permanent loss in value of the portfolio and there is no present intention to liquidate the securities at less than cost.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which include the amortization of assets recorded under capital leases, are computed principally on the straight-line basis. Buildings and land improvements are depreciated based on lives varying from ten to forty years and equipment based on lives varying from three to twenty years. Leasehold improvements are amortized over their useful lives which generally approximate twelve and one-half years.

Excess of Cost of Investments in Consolidated Subsidiaries Over Equities in Net Assets

The excess of cost of investments in consolidated subsidiaries over equities in net assets at dates of acquisition originating prior to November, 1970 is not amortized because, in the opinion of management, there has been no decrease in value. Amounts arising after October, 1970 are not significant and are amortized on the straight-line basis over forty years.

Capitalization of Interest

Interest attributed to funds used to finance major capital expenditures is capitalized as an additional cost of the related assets. Capitalization of interest ceases when the related assets are substantially complete and ready for their intended use.

Deferred Federal Income Taxes and Investment Tax Credits

Deferred federal income taxes consist primarily of the amount of tax applicable to the excess of depreciation for tax purposes over depreciation used for financial reporting purposes less the amount of tax applicable to the unfunded pension liability.

Investment tax credits are included as reductions of income tax expense in the years in which the credits arise.

Discontinued Operations

In 1980, the Company decided to dispose of its investments in the amusement park business. The Company and Taft Broadcasting Company (Taft) had been 50% joint-owners of Family Leisure Centers, Inc. (FLC), which operated the Carowinds and Kings Dominion amusement parks, and the Hanna-Barbera's Marineland amusement park. A reorganization of FLC during 1980 resulted in the Company increasing its ownership to 81% from 50% and Taft becoming the sole owner of Carowinds. Under a subsequent agreement, the Company sold the Kings Dominion assets to Taft for one million shares of Taft Series B preferred stock (Series B Stock) with a par value of $20 per share with an estimated value of $17,800. The Series B Stock, which is included in Other Investments at January 2, 1982, receives an annual dividend of $1.38 per share. Taft will redeem the Series B Stock in varying amounts beginning in 1982, with all shares to be redeemed by 1993. The sale of the Kings Dominion assets provided approximately $18,000 in tax benefits. The loss on discontinued operations, after deducting anticipated tax benefits, was provided at January 3, 1981, to reflect the estimated net realizable value of the Company's investments in amusement parks.

During 1981, the Company sold its interest in the Hanna-Barbera's Marineland amusement park. The amount of loss on discontinued operations in 1981 represents the excess of the actual loss from discontinued operations over the amount estimated at January 3, 1981.

Inventories

Inventories are stated at the lower of cost, determined principally on the last-in, first-out (LIFO) method, or market. Approximately 72% of inventories for 1981 and 68% of inventories for 1980 were valued using the LIFO method. Cost for the balance of the inventories was determined by the first-in, first-out (FIFO) method of inventory valuation.

The Company uses the LIFO method of valuing certain of its grocery inventories to minimize inflation-induced inventory profits and to achieve a better matching of current costs with current revenues. Supplemental FIFO information (net earnings plus the after-tax effect of the LIFO charge) is presented below to permit a more complete comparison to various other companies. Earnings and earnings per share on a FIFO basis for the three fiscal years ended January 2, 1982 were:

	From Continuing Operations		Net	Net Earnings
	Earnings	Per Share (primary)	Earnings	Per Share (primary)
1981	$145,938	$5.14	$144,498	$5.09
1980	$130,011	$4.70	$121,611	$4.39
1979	$105,516	$3.85	$105,516	$3.85

Property Held for Resale

Property held for resale represents the cost of certain land and buildings committed by the Company for sale and leaseback during the next year and on which title has not transferred to a purchaser. At January 2, 1982, the Company had formal financing agreements for approximately $12,941 of these properties and has additional commitments available for the remaining properties.

Marketable Investment Securities

Marketable investment securities consist of:

	1981	1980
Equity securities, at cost	$26,762	$26,762
Less valuation allowance charged against shareowners' equity	(11,843)	(10,139)
Equity securities, at market	14,919	16,623
Bonds and notes, at cost	853	853
	$15,772	$17,476

The portfolio of equity securities included gross unrealized losses of $11,843 at January 2, 1982. There were no realized gains or losses on marketable investment securities in 1981 or 1979. Net realized losses included in earnings amounted to $94 in 1980. The valuation allowance charged against shareowners' equity increased $1,704 during 1981 and $351 during 1979. The valuation allowance decreased $1,559 during 1980, with $94 charged against earnings.

Debt Obligations

Long-term debt as of January 2, 1982 and January 3, 1981 consists of:

	1981	1980
Senior debt:		
14⅜% notes maturing in 1991	$ 50,000	
12⅜% sinking fund debentures maturing in 2005, with annual payments of $2,500 required from 1988 through 2004	50,000	$ 50,000
9⅞% notes maturing in 1983	33,284	39,870
9% sinking fund debentures maturing in 1995, with annual payments of $2,500 required from 1985 through 1995	27,248	30,390
8.7% sinking fund debentures maturing in 1998, with annual payments of $3,000 required from 1984 through 1998	45,189	47,784
8½% sinking fund debentures maturing in 2001, with annual payments of $2,500 required from 1985 through 2001	42,217	43,550
6⅜% to 14¼% industrial revenue bonds, with annual payments due in varying amounts through 2021	100,685	28,550
4½% to 9½% secured notes, annual payments due in varying amounts through 2004	27,474	30,332
5.3% notes which matured in 1981		3,750
	376,097	274,226
Less amount due within one year	(3,281)	(6,080)
Total senior debt	372,816	268,146
Subordinated debt:		
10¼% convertible subordinated sinking fund debentures maturing in 2006, with annual payments of $2,500 required from 1992 through 2006	50,000	
Total long-term debt	$ 422,816	$ 268,146

The aggregate annual maturities and required payments of long-term debt for the five years subsequent to 1981 are:

1982	$ 3,281
1983	$42,715
1984	$ 6,178
1985	$10,851
1986	$11,495

Under certain of the loan agreements, payments of cash dividends are limited. Under the most limiting agreement, accumulated earnings were unrestricted in the amount of $186,000 at January 2, 1982.

The convertible subordinated debentures are convertible prior to maturity at a conversion price of $29.24 per share.

The Company periodically engages in short-term borrowing activities. There were no short-term borrowings outstanding at January 2, 1982. Short-term borrowing activity for the three fiscal years ended January 2, 1982, was:

	1981	1980	1979
Weighted average for the year	$16,412	$ 8,907	$ 3,890
Highest level outstanding during the year	$73,265	$31,779	$41,975
Weighted average interest rate	16.0%	13.9%	14.6%

At January 2, 1982, the Company had available a revolving credit aggregating $100,000, against which it may obtain interim loans until May 1, 1983. The interest rate on the interim loans would vary between the higher of 108% to 109% of the prime rate or the New York Composite 90 Day Certificate of Deposit Rate. At the Company's request, the interim loans may be converted into a term loan payable over four years. No amounts have been borrowed under this agreement.

The Company also had available lines of credit amounting to $23,200. The interest rate would be the prime rate at time of borrowing. These lines are subject to annual review by each bank.

Interest costs capitalized in 1981, 1980 and 1979 amounted to $4,351, $1,327 and $942, respectively.

The Company has guaranteed $17,000 of industrial revenue bonds issued in connection with store properties under construction at January 2, 1982.

Leases

The Company operates principally in leased premises. Lease terms generally range from ten to twenty-five years with options of renewal for additional periods.

Options provide in some cases for reduced rentals and/or the right to purchase. Certain of the leases provide for contingent rentals based upon a percent of sales.

Rent expense (under operating leases) consists of:

	1981	1980	1979
Minimum rentals, net of minor sublease rentals	$ 130,838	$ 118,404	$ 101,904
Contingent rentals	13,164	12,228	10,623
Total	$ 144,002	$ 130,632	$ 112,527

Assets recorded under capital leases consist of:

	1981	1980
Distribution and manufacturing facilities	$ 97,216	$ 97,213
Store facilities	76,264	55,653
Less accumulated amortization	(46,412)	(41,486)
	$ 127,068	$ 111,380

Minimum annual rentals, net of subleased rentals which are minor in amount, for the five years subsequent to 1981 and in the aggregate are:

	Capital Leases	Operating Leases
1982	$ 18,841	$ 145,648
1983	18,580	142,367
1984	18,169	138,963
1985	17,596	135,657
1986	16,817	131,108
1987 and thereafter	263,507	1,408,930
	353,510	$2,102,673
Less estimated executory costs included in capital leases	(20,074)	
Net minimum lease payments under capital leases	333,436	
Less amount representing interest	(194,720)	
Present value of net minimum lease payments under capital leases	$ 138,716	

Preferred Stock

In 1981, the Company entered into a financing arrangement with an investor company to own jointly a subsidiary, Kroco, Inc. (Kroco), which was formed in 1981. The Company contributed $50,000 of plant, inventories and cash to Kroco in exchange for 100% of Kroco's common stock with a 20% voting interest, $20,000 of Kroco non-voting 7% preferred stock and $20,000 Kroco 9% convertible debenture. The investor company invested $50,000 in cash in exchange for the 9% cumulative voting preferred stock of Kroco with an 80% voting interest. In January, 1982, Kroco invested $50,000 in 500,000 shares of the Company's cumulative convertible preferred stock with a 9% dividend rate, the holders of which are entitled to one vote per share. The voting preferred stock of Kroco may be exchanged for the Company's 9% cumulative convertible preferred stock held by Kroco which is convertible into

the Company's common stock at a price of $38.26 per share declining to $33.15 per share in January, 1985. The convertible debenture held by the Company can be converted after October 31, 1986, or prior thereto upon the occurrence of certain events, into Kroco common shares which would result in the Company having two-thirds voting control of Kroco.

The Company and Kroco formed a partnership BHK, Ltd. (BHK) as part of the financing arrangement. Kroco contributed the plant, inventories and cash received from the Company for a 90% limited partnership interest. The Company contributed $11,000 of plant and inventories for a 10% general partnership interest.

As the general partner, the Company accounts for its interest in BHK using the consolidation method of accounting. The investment in Kroco is accounted for using the equity method. The Company's equity in the earnings of Kroco, $8,932 in 1981, is reported on a pre-tax basis and is offset by $7,758, which represents the minority interest in the earnings of BHK. The Kroco earnings also include $1,174 of net interest income. Also, the minority interest in the net assets of BHK, $57,758, has been netted against the Company's investment in Kroco, $58,932, in the Company's consolidated balance sheet so that the consolidated balance sheet reflects the Company's interest in the various assets owned by BHK. As the investor company owns 80% of the voting control of Kroco and includes the taxable income of Kroco in its consolidated tax return, the tax expense of Kroco included in the Company's financial statements represents amounts payable to the investor company under a tax allocation agreement.

Since the $50,000 was invested by the investor company in 1981, activity related to the agreement, including the payment by Kroco of $963 in dividends to the holder of the 9% preferred stock and the exchange of the $50,000 for the Company's preferred stock issued to Kroco on January 22, 1982, has been included in the Company's financial statements as of January 2, 1982. The net effect of this financing arrangement was to generate cash and increase equity by $50,000.

A Director of the Company is President and a Director of the investor company and another Director of the Company is also a Director of the investor company.

Stock Option Plans

At January 2, 1982, options were outstanding to purchase 1,329,695 shares of common stock under the 1969, 1976, and 1981 Stock Option Plans (of which options on 844,715 shares were exercisable at that date) at prices ranging from $7.78 to $25.44 a share. Each option outstanding was granted at an option price equal to the fair market value of the stock at the date of grant. No further options may be granted under the 1969 Plan. Options may be granted under the 1976 and 1981 Plans until 1986 and 1991, respectively. At January 2, 1982, shares of common stock available for future options under the 1976 and 1981 Plans amounted to 32,313 and 684,400 shares, respectively. At January 3, 1981, 48,613 shares of common stock were available for future options under the 1976 Plan.

Changes in options outstanding under the Stock Option Plans of the Company were:

	Shares Subject To Option	Option Price Range Per Share
Outstanding, December 30, 1978	1,085,804	$ 7.78-$16.53
Granted	104,000	$17.94-$25.06
Exercised	(196,081)	$ 7 78-$17.94
Cancelled or expired	(29,400)	$ 9.60-$17.94
Outstanding, December 29, 1979	964,323	$ 7.78-$25.06
Granted	249,000	$16.63-$22.00
Exercised	(89,680)	$ 7.78-$17.94
Cancelled or expired	(7,505)	$12.85-$19.75
Outstanding, January 3, 1981	1,116,138	$ 7.78-$25.06
Granted	342,600	$20.31-$25.44
Exercised	(103,154)	$ 7.78-$19.75
Cancelled or expired	(25,889)	$ 7.91-$21.25
Outstanding, January 2, 1982	1,329,695	$ 7.78-$25.44

The stock option plans provide for the exercise of options either by exchanging issued shares of stock of the Company in lieu of cash payments, or in cash.

The Company has made Stock Appreciation Rights (SAR) available to certain officers. In general, the eligible optionees are permitted to surrender the related option and receive cash and shares of the Company's common stock having a value equal to the appreciation on the shares subject to the option. The appreciation of SAR is charged to earnings based upon the market value of common stock. At January 2, 1982, rights related to options for 50,150 shares were outstanding and exercisable at prices ranging from $7.78 to $9.60 per share, expiring in 1982.

Under the Company's dividend reinvestment plan, shareowners of record may purchase additional shares of common stock by reinvesting dividends or making optional cash investments.

Taxes Based on Income

The provision for taxes based on income consists of:

	1981	1980	1979
Federal:			
Current	$25,987	$31,796	$32,128
Deferred	20,578	13,091	13,472
	46,565	44,887	45,600
State and Local:			
Current	14,243	14,887	15,187
Payments in lieu of federal income taxes	3,997		
Total	$64,805	$59,774	$60,787

Investment and other tax credits reduced the tax provision by $27,652 in 1981, $18,217 in 1980 and $12,717 in 1979.

Payments in lieu of federal income taxes represent the estimated amounts payable to Baldwin-United Corporation under a tax allocation agreement. See Preferred Stock note.

A reconciliation of the statutory federal rate and the effective rates is as follows:

	1981	1980	1979
Statutory rate	46.0%	46.0%	46.0%
State income taxes, net of federal tax benefit	4.0	4.9	5.6
Investment and other tax credits	(14.2)	(11.2)	(8.7)
Other, net	(2.4)	(2.9)	(1.4)
Effective rate	33.4%	36.8%	41.5%

Deferred federal income taxes included in the Consolidated Statement of Earnings consist of:

	1981	1980	1979
The tax effect of amounts expensed (included in earnings) for tax purposes in excess of amounts used for financial reporting:			
Depreciation	$19,831	$11,785	$ 9,372
Excess pension contribution	(410)	475	5,059
Other	1,157	831	(959)
Total	$20,578	$13,091	$13,472

In 1973, the Company discontinued the LIFO method of valuing inventories and received Internal Revenue Service permission to spread the tax liability resulting from the change over a twenty year period. As a result of readopting the LIFO method of valuing inventories during 1979, deferred taxes, amounting to $16,811, became currently payable at December 29, 1979, in addition to the $32,128 reflected in the Consolidated Statement of Earnings.

Pension Plans

The Company has three noncontributory retirement plans for eligible employees, two of which have historically been funded. The third retirement plan, which was previously unfunded, is being funded over a period of forty years. The Company also contributes to multi-employer plans jointly administered by management and union representatives. The total pension expense for 1981, 1980 and 1979 was $94,658, $85,587 and $71,882, respectively. Past service costs of the Company's plans are amortized over periods ranging from thirty to forty years.

Accumulated plan benefits and plan net assets for the Company administered plans were:

	January 1, 1981	January 1, 1980
Actuarial present value of accumulated plan benefits.		
Vested	$198,181	$193,120
Nonvested	19,395	6,455
	$217,576	$199,575
Net assets available for benefits	$186,791	$144,767

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 6½%.

Information with respect to the actuarial present value of accumulated plan benefits and net assets available for benefits relating to the multi-employer plans was not available.

Earnings Per Share

During 1981, the Company issued convertible debentures and convertible preferred stock which resulted in the dilution of earnings per share of common stock. Primary earnings per share for 1981, is computed by dividing net earnings by the weighted average number of shares of common stock and dilutive common stock equivalents outstanding during the year. Common stock equivalents include shares issuable upon exercise of outstanding stock options and conversion of the Company's cumulative convertible preferred stock. Fully diluted earnings per share for 1981, is computed by dividing net earnings, after the elimination of interest expense, net of income tax effect, applicable to the Company's convertible debentures, by the weighted average

number of shares of common stock, dilutive common stock equivalents and shares issuable upon conversion of the Company's convertible debentures. The weighted average number of shares of common stock outstanding for 1980 and 1979 does not include common stock equivalents because the resulting dilution of earnings per share of common stock is not material.

The average number of shares used to compute earnings per share was:

	Primary	Fully Diluted
1981	28,369	29,726
1980	27,681	27,681
1979	27,407	27,407

Litigation

There are pending against the Company various claims and lawsuits arising in the normal course of business including, as of January 2, 1982, suits charging violations of certain antitrust and civil rights laws. Some of these suits purport or have been determined to be class actions and/or seek damages in very large amounts. Any damages that may be awarded in antitrust cases will be automatically trebled.

Seventeen antitrust suits alleging, among other things, price-fixing in the purchase and sale of meat, have been consolidated for pretrial and discovery purposes in the United States District Court in Dallas. On December 27, 1977, the Court entered a judgment dismissing nine of these suits which had been filed in 1975 and 1976. Appeals were filed in eight of the dismissed suits. The Fifth Circuit Court of Appeals reversed the dismissals and remanded the cases for further proceedings. No appeal was filed in the ninth suit, but a similar suit was filed in California under state antitrust statutes. That case was dismissed, and an appeal from such dismissal has been taken. The complaints in the remaining eight suits, which were filed in 1977 and 1981, include certain allegations not contained in the earlier filed suits. Since discovery has been very limited, and since each of the suits, if tried at all, may go to a jury, the Company cannot predict their ultimate outcome. The Company believes, however, that it has substantial defenses available and should prevail in all.

Although the amount of liability at January 2, 1982 with respect to all claims and lawsuits cannot be ascertained, the Company is of the opinion that any resulting liability will not have a material effect upon the Company's financial position.

Segments of Business

The Company's segments of business information for 1981, 1980 and 1979 are included on page 22.

Changing Prices (Unaudited)

The Company's information regarding the impact of changing prices on a constant dollar and current cost basis is presented on pages 30-32.

Report of Independent Certified Public Accountants

To the Shareowners and Board of Directors
The Kroger Co.

We have examined the consolidated balance sheets of The Kroger Co. and Consolidated Subsidiary Companies as of January 2, 1982 and January 3, 1981, and the related consolidated statements of earnings, shareowners' equity and changes in financial position for the years ended January 2, 1982, January 3, 1981 and December 29, 1979. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of The Kroger Co. and Consolidated Subsidiary Companies at January 2, 1982 and January 3, 1981, and the consolidated results of their operations and changes in their financial position for the years ended January 2, 1982, January 3, 1981 and December 29, 1979, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers + Lybrand
Coopers & Lybrand
Cincinnati, Ohio
February 18, 1982

Supplemental Inflation Adjusted Financial Information (unaudited)

In an effort to produce financial information that discloses the effects of inflation, the Financial Accounting Standards Board (FASB) issued Statement No. 33, Financial Reporting and Changing Prices, which requires companies to explain the effect of inflationary factors on their operations by adjusting historical financial information using two different methods. This information includes disclosures about the effects of changes in both general inflation (constant dollars) and specific prices (current cost).

The constant dollar method measures the effect of the general rate of inflation on the Company's earnings, by expressing certain historical cost amounts in units of the same purchasing power as measured by the Consumer Price Index for All Urban Consumers (CPI-U). This measure of general inflation encompasses a wide range of commodities and is not necessarily representative of the inflation effect upon our business. The current cost method attempts to reflect the changes in prices of the resources employed specifically in our operations. These methods involve the use of assumptions, approximations and estimates. The results should not be viewed as precise measurements of the effects of inflation.

Earnings derived under these methods include adjustments to merchandise costs and depreciation and amortization expense for these inflationary factors. The effects of inflation, on merchandise costs, are recognized in the historical financial statements, to some extent, due to the use of the LIFO method of inventory valuation.

The accompanying statement of earnings and five-year summary of selected financial data were prepared to reflect those inflationary factors due to increases in the historical costs of merchandise and depreciation and amortization and their related assets. Amounts prior to 1981, have been adjusted to average 1981 dollars by use of the CPI-U.

The restated net assets result in an indicated increase in shareowners' equity which was greater on a specific price basis than that of general inflation. The gain from decline in purchasing power of net amounts owed is primarily attributable to the debt which has been used to finance inventories and capital expenditures. During a period of inflation, holders of monetary assets suffer an unrealized loss of general purchasing power, while holders of monetary liabilities experience an unrealized gain.

Both the constant dollar method and the current cost method result in lower net earnings than reported in the primary financial statements. Taxation of earnings under present tax law reduces the amount of earnings available to support future business growth because these changing prices adjustments are not deductible for income tax purposes. The effects of the higher taxation of earnings are demonstrated in the effective tax rates shown on the supplementary income statement.

Consolidated Statement of Earnings from Continuing Operations Adjusted for Changing Prices

For the Year Ended January 2, 1982 (52 Weeks) (In thousands of dollars)

	As Reported In The Primary Statements (Historical Costs)	Adjusted For General Inflation (Average 1981 Constant Dollars)	Adjusted For Changes In Specific Prices (1981 Current Costs)
Sales	$ 11,267,000	$ 11,267,000	$ 11,267,000
Costs and Expenses:			
Merchandise costs, including warehousing and transportation	8,645,000	8,665,000	8,651,000
Operating, general and administrative expenses	2,148,000	2,148,000	2,148,000
Rent	144,000	144,000	144,000
Depreciation and amortization	104,000	125,000	151,000
Dividend and interest income	(14,000)	(14,000)	(14,000)
Interest expense, including interest on obligations under capital leases	46,000	46,000	46,000
Total	11,073,000	11,114,000	11,126,000
Earnings from continuing operations before taxes based on income	194,000	153,000	141,000
Taxes based on income	65,000	65,000	65,000
Earnings from continuing operations	$ 129,000	$ 88,000	$ 76,000
Effective tax rate—taxes based on income	33.5%	42.5%	46.1%
Gain from decline in purchasing power of net amounts owed		$ 99,000	$ 99,000
Increase in specific prices of inventories and property, plant and equipment			$ 125,000
Less effect of increase in general prices			210,000
Excess of increase in specific prices over increase in general prices			$ (85,000)

At January 2, 1982 specific prices of inventories totaled $930,000 and specific prices of property, plant and equipment, net of accumulated depreciation totaled $1,670,000.

The adjustment to merchandise costs, including warehousing and transportation, in the supplemental income statements is approximately one percent, which reflects the Company's use of the LIFO method of accounting for approximately 72% of its inventories. The difference results primarily from restating the remaining inventories to a current cost equivalent. The constant dollar merchandise cost adjustment is larger due to the higher rate of increase of the CPI-U for 1981 as compared with the Company's specific price indexes.

Five-Year Comparison of Selected Financial Data Adjusted for Effects of Changing Prices

(In thousands of average 1981 dollars, except per share figures)

	1981	1980 (a)	1979	1978	1977
Sales	$ 11,267,000	11,387,000	11,314,000	10,913,000	10,127,000
Constant Dollar Data:					
Earnings from continuing operations	$ 88,000	46,000	43,000	15,000	10,000
Primary earnings per share from continuing operations	$ 3.09	1.66	1.55	.56	.36
Net assets at year-end	$ 1,372,000	1,295,000	1,196,000	1,075,000	1,024,000
Current Cost Data:					
Earnings from continuing operations	$ 76,000	38,000	30,000		
Primary earnings per share from continuing operations	$ 2.70	1.38	1.10		
Net assets at year-end	$ 1,494,000	1,417,000	1,271,000		
Excess of increase in specific prices over increase in general prices	$ (85,000)	41,000	(11,000)		
General Information:					
Gain from decline in purchasing power of net amounts owed	$ 99,000	126,000	136,000	93,000	68,000
Dividends per share	$ 1.57	1.54	1.58	1.24	1.14
Market price per share at year-end	$ 25⅛	22⅞	22½	23⅞	20¼
Average consumer price index	272.4	246.8	217.4	195.4	181.5

(a) Fifty-three weeks

Notes to Supplementary Data on Changing Prices

Accounting Policies

The supplementary data on changing prices is based upon the historical financial information as reported in the primary financial statements adjusted for (1) general inflationary factors relating to property, plant, and equipment and inventories and (2) the changes in specific prices relating to these items.

Depreciation expense was calculated using the same methods and rates of depreciation as used in the historical financial statements.

Income tax expense has not been modified for any timing differences, allocations or adjustments that may result from applying the different methods in preparing the supplementary data.

No attempt has been made to calculate the benefit derived from additional realization of selling price increases necessitated by a higher level of cost of operations resulting from the application of the constant dollar or current cost adjustments to the original historical cost of property, plant, and equipment and inventories.

Constant Dollars

The supplementary data on a constant dollar basis is expressed in average for the year dollars and reflects adjustments that have occurred in the purchasing power of the dollar as measured by the CPI-U published by the Bureau of Labor Statistics. These amounts do not purport to represent appraised values or any other measure of current value.

Current Cost

The current cost of inventories, and merchandise costs, represents the cost of purchasing the goods at year-end prices for inventory and prices in effect at date of sale for merchandise costs. They are estimated based upon the latest prices and information of merchandise costs available as of January 2, 1982.

The current cost of property, plant, and equipment and the related depreciation expense are estimates of what the Company's existing assets would cost at the respective balance sheet dates. The amounts for 1979 and 1980 have been adjusted to average 1981 dollars based on the CPI-U. Several methods, including indexation, direct pricing and application of square footage building and equipment costs based upon current merchandising and facility concepts, were used in estimating these amounts. These values represent the estimated current costs of existing assets and do not consider technological improvements and efficiencies associated with the normal replacement of productive capacity.

Selected Financial Data (unaudited)

(In thousands of dollars except per share amounts)

	1981 (52 Weeks)	1980 (53 Weeks)	1979 (52 Weeks)	1978 (52 Weeks)	1977 (52 Weeks)
Sales	$11,266,520	10,316,741	9,029,315	7,828,071	6,747,553
Earnings from continuing operations (a)	$ 129,484	102,786	85,721	84,596	60,023
Earnings per share from continuing operations: primary	$ 4.56	3.71	3.13	3.11	2.22
fully diluted	$ 4.43	3.71	3.13	3.11	2.22
Total assets	$ 2,405,290	1,998,494	1,786,691	1,653,029	1,528,721
Long-term obligations, including obligations under capital leases	$ 564,813	395,786	346,201	335,450	345,078
Cash dividends declared per common share	$ 1.57	1.40	1.26	.89	.76

(a) In 1979, the Company changed from the First-In, First-Out (FIFO) method of valuing certain of its grocery inventories to the Last-In, First-Out (LIFO) method.

Ten Year Summary

	1981	1980	1979	1978
Operations (In thousands of dollars, except per share figures)				
Sales	**$ 11,266,520**	10,316,741	9,029,315	7,828,071
Costs and Expenses	**$ 11,072,231**	10,154,181	8,882,807	7,674,815
Earnings from Continuing Operations before Taxes Based on Income	**$ 194,289**	162,560	146,508	153,256
Taxes Based on Income	**$ 64,805**	59,774	60,787	68,660
Earnings from Continuing Operations	**$ 129,484**	102,786	85,721	84,596
Discontinued Operations	**$ (1,439)**	(8,400)		
Net Earnings	**$ 128,045**	94,386	85,721	84,596
Dividends on Common Stock	**$ 43,771**	38,768	34,524	24,218
Earnings Per Share From Continuing Operations	**$ 4.56**	3.71	3.13	3.11
Discontinued Operations	**$ (.05)**	(.30)		
Net Earnings	**$ 4.51**	3.41	3.13	3.11
Dividends Paid Per Share of Common Stock	**$ 1.57**	1.40	1.26	.89
Balance Sheet Statistics (In thousands of dollars, except per share figures)				
Inventories	**$ 810,946**	775,268	780,698	697,327
Working Capital	**$ 396,245**	241,904	264,537	308,677
Property, Plant and Equipment, net	**$ 1,052,764**	884,617	725,220	621,292
Total Assets	**$ 2,405,290**	1,998,494	1,786,691	1,653,029
Long-Term Debt	**$ 422,816**	268,146	233,937	223,736
Shareowners' Equity	**$ 807,471**	671,366	611,328	554,507
Per Share of Common Stock	**$ 27.06**	24.17	22.14	20.34
Other Statistics (In thousands of dollars, except stock prices)				
Funds Provided from Operations	**$ 253,878**	220,137	170,767	160,080
Capital Expenditures	**$ 260,218**	239,130	176,933	114,504
Rent	**$ 144,002**	130,632	112,527	99,785
Interest Expense	**$ 45,778**	35,736	29,385	29,983
Common Stock Price Range	**$ 19¼-27⅞**	14-23¾	17½-27	12¾-18½
Retail Facilities (areas in thousands of square feet)				
Food Stores Opened	**111**	118	88	104
Remodeled	**57**	49	91	58
Closed	**98**	107	56	90
Stores—End of Year	**1,258**	1,245	1,234	1,202
Total Area	**36,985**	34,529	32,460	30,673
Drug Stores Opened and Acquired	**57**	42	38	7
Closed	**64**	32	21	48
Stores—End of Year	**507**	514	504	487
Total Area	**5,715**	5,841	5,657	5,591

— In 1979, the Company changed from the First-In, First-Out (FIFO) method of valuing certain of its grocery inventories to the Last-In, First-Out (LIFO) method.

— 1976 and 1980 were fifty-three week years

— In 1972 the Family Center operations were discontinued resulting in an extraordinary loss of $5,341 or $ 20 per share There was a credit of $587 or $.02 per share resulting from a change in the method of applying an accounting principle

— Amounts for 1973 and 1972 were not restated for a change in accounting for leases and for the consolidation of previously unconsolidated subsidiaries Restatement would not have a material effect on the amounts reported.

1977	1976	1975	1974	1973	1972
6,747,553	6,182,991	5,421,296	4,893,384	4,319,960	3,799,019
6,640,881	6,097,816	5,362,417	4,811,772	4,266,267	3,762,130
106,672	85,175	58,879	81,612	53,693	36,889
46,649	37,250	24,822	36,729	23,777	11,762
60,023	47,925	34,057	44,883	29,916	25,127
					(4,754)
60,023	47,925	34,057	44,883	29,916	20,373
20,551	18,577	18,298	18,088	17,461	17,406
2.22	1.78	1.26	1.66	1.11	.94
					(.18)
2.22	1.78	1.26	1.66	1.11	.76
.76	.69	.68	.67	.65	.65
623,645	558,347	500,110	490,640	438,219	358,038
294,157	298,528	216,524	158,418	229,095	178,743
570,989	544,472	534,979	526,439	344,088	332,065
1,528,721	1,445,302	1,302,049	1,269,045	1,077,517	873,577
238,892	259,561	213,085	164,498	151,471	94,017
489,972	455,273	423,721	418,477	392,852	380,041
18.06	16.85	15.71	15.51	14.57	14.12
130,750	114,327	95,579	101,222	71,719	54,537
96,417	81,906	70,161	116,720	70,244	55,335
88,363	82,611	74,632	67,341	71,925	60,114
30,626	27,713	25,438	23,384	12,199	8,921
11⅝-14⅜	8⅞-12⅝	7⅞-12⅛	7⅛-12½	7½-12¼	9½-16⅞
98	90	71	83	80	59
35	33	40	84	68	57
83	137	92	127	160	126
1,188	1,173	1,220	1,241	1,285	1,365
28,642	26,850	26,415	25,594	24,706	24,896
11	20	56	64	36	46
41	13	27	35	19	28
528	558	551	522	493	476
6,108	6,399	6,234	5,633	4,883	4,525

Directors

William D. Atteberry
Chairman of the Board and Chief Executive Officer, Eagle-Picher Industries, Inc.

Philip E. Beekman
President, The Seagram Company Ltd.

Raymond B. Carey, Jr.
Chairman of the Board and President, American District Telegraph Company

Lyle Everingham
Chairman of the Board, President and Chief Executive Officer

James P. Herring
Former Chairman of the Board

Jackson C. Hinds
Chairman of the Board and Chief Executive Officer, Entex, Inc.

Patricia Shontz Longe
Economist and Professor, Business Administration, University of Michigan

T. Ballard Morton, Jr.
Vice Chairman, Cosmos Broadcasting Corporation

Thomas H. O'Leary
President, Missouri Pacific Corporation

John D. Ong
Chairman, President and Chief Executive Officer, The B F. Goodrich Company

W. George Pinnell
Executive Vice President, Indiana University

R. Nelson Shaw
Former Chairman, Mercantile Stores Company, Inc

Edward D. Smith
Of Counsel to Hansell, Post, Brandon & Dorsey, Atlanta Attorneys

Morley P. Thompson
President, Baldwin-United Corporation

Russell L. Wagner
Former Chairman of the Board and Chief Executive Officer, NLT Corporation

Committees of the Board

Kroger has an active, working Board of Directors, which provides insight and expertise to Kroger management as representatives of the shareowners. In addition to the advice and counsel directors provide through regular Board meetings, they give specialized assistance through service on the Board committees, listed below, that help us run a better business.

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Jackson C. Hinds
Patricia Shontz Longe
T Ballard Morton, Jr.
Morley P. Thompson

Compensation Committee
W. George Pinnell, Chairman
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Raymond B. Carey, Jr.
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Jackson C. Hinds
T. Ballard Morton, Jr.
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Lyle Everingham
James P. Herring
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Pension Plan Committee
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R. Nelson Shaw

Corporate Officers

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Vice President

Robert W. Braunschweig
Vice President

John A. Cornett
Senior Vice President

Lyle Everingham
Chairman of the Board, President and Chief Executive Officer

Jack G. Hudson
Vice President and Controller

Arthur Juergens
Vice President

William G. Kagler
Senior Vice President

George W. Keith
Vice President, Chairman, SupeRx Drug Stores

Lorrence T. Kellar
Vice President and Treasurer

Richard M. Koster
Group Vice President

George A. Leonard
Vice President, Secretary and General Counsel

William W. Oliver
Group Vice President

Robert E. Saffron
Vice President

William J. Sinkula
Vice President

John L. Strubbe
Group Vice President

Charles L. Thomas
Group Vice President

Gerald L. Wolken
Vice President, President, SupeRx Drug Stores

Form 10-K
A copy of the Company's 1981 report to the Securities and Exchange Commission, Form 10-K, is available to shareowners on request by writing: Lorrence T. Kellar, Vice President and Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201.

Annual Meeting
The annual meeting of shareowners will be held at the Cincinnati Convention Center, Fifth and Elm Streets, Cincinnati, Ohio, on May 21, 1982, at 10 a.m.

Transfer Agent and Registrar
The First National Bank of Cincinnati
First National Bank Center
Fifth and Walnut Streets
Cincinnati, Ohio 45201
Telephone: 513-632-4648

The 1981 Kroger Annual Report has been recorded and is available on cassette tape for the visually impaired. The tape is free to shareowners and may be ordered by writing to Public Affairs Department, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201.

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Kroger

The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201 (513) 762-4000